

Payroll Trends

1st Quarter 2008

FMLA Leave for Military Families Now Law

Family and Medical Leave Act (FMLA) protections are now available to the families of wounded military service members under the 2008 Defense Department Authorization Bill signed into law on January 29, 2008. An employee who is a spouse, child, parent or next of kin is eligible for a total of 26 weeks of unpaid leave during a 12 month period to care for the wounded service member. Qualified emergencies are entitled for up to 12 weeks FLMA leave, with the definition of qualified emergency yet to be provided.

Cell Phones

Currently a cell phone and Blackberry are considered listed property by the IRS, meaning they are employer-provided equipment that can be used for personal purposes. Therefore, to exclude the value of the employer-provided phone from the employee's taxable income, the business versus personal use must be substantiated.

Congress has begun the process to liberalize the rules for employer-provided cell phones and similar devices, sighting the unlimited and free airtime that adds no additional cost for personal use and the necessary nature for employers of extending the workday through their use. Look for action in this area some time this year.

Expense Reimbursements

The IRS has issued an "alert" announcing an IRS team to address employer treatment of tool allowances under an accountable plan. As with all accountable plan expense reimbursements, tool or other allowances are tax-exempt only if there is a business purpose, substantiation of the expense and any excess amounts over actual expenses are returned to the employer.

The alert reiterates that plans that designate a structured portion of existing pay as an expense allowance without substantiation, and that result in the same gross pay, are merely tax avoidance schemes. Under accountable plan rules, all expense reimbursements by the employer could be in disqualification jeopardy.

In a similar notice, the IRS reissued interim guidance on per diem allowances and abuses. The notice warns that employer failure to track excess allowances and routine payment of excess allowances not treated as wages will be considered a pattern of abuse causing all payments under their expense reimbursement plan to be nonaccountable, with the expense reimbursements required to be treated as wages subject to employment taxes.

Both of these notices indicate an assumed problem in the expense reimbursement area, with increased legislation or audit activity a strong possibility.

Minimum Wage

Preparations should be made to increase the federal minimum wage to \$6.55 effective July 24, 2008 as provided by the phased provisions of the Fair Minimum Wage Act of 2007. State laws with minimums in excess of \$6.55 are applicable for employees in those states.

Tax Deposit Fines

A U.S. District Court has upheld the IRS in assessing failure to deposit penalties for payroll tax deposits made on time and for the proper amount, but not filed electronically. If you are not currently a client of ours and have any questions about the tax deposit schedules or required electronic deposits, contact us for more information in meeting your compliance requirements.

Immigration Fines

For the first time since 1999, the Homeland Security and Justice Departments have increased fines for immigration violations. Cost-of-living adjustments are allowed under federal law, with a cumulative increase of 25.35% from June, 1999 to June, 2007.

Payroll Controls

Employers should be aware payroll can be a source of fraud against the employer and against their employees. Fraudulent checks can be written for non-existent employees or payroll amounts can be inflated. Likewise, payroll records can be used for identity fraud against employees. Therefore, employers should always look at payroll for reasonableness, occasionally review cancelled payroll checks and payroll ledgers., etc. In addition, payroll records should be secure, with locked cabinets, password protected computers, etc. to limit identity theft.

Professional Partnership

The long term trend of constant changes in payroll-related compliance continues with new regulations and Congressional action, as well as state and local changes. If you are trying to keep up with all of this compliance activity on a part-time basis, why not let us discuss with you the services, or additional services, we can provide to allow you to maximize your business potential.

FMLA

On February 11, 2008 the Dept. of Labor (DOL) issued proposed regulations revising the Family and Medical Leave Act (FMLA). A comment period is available until April 11, 2008, then the regulations will be considered in light of the comments and will be effective upon final release.

Among the revisions is a clarification that if the twelve months of employment for eligibility is not consecutive and there has been a break in service of five years or more, prior service is not required to be considered for current eligibility.

An exception to this new, five-year rule would be if the break in service is for fulfillment of military obligations. Another exemption would be for approved absences or leave for education,

or raising a child, when a written agreement or collective bargaining agreement is in existence indicating rehire is intended.

The new, five-year rule can be waived, but must be done so for all employees. Also clarified is that if a person is on leave when the 12 month service requirement is met, the period of leave prior to the anniversary date is not FMLA leave, while that after the eligibility date is FMLA leave.

Continuing treatment to establish a serious health condition would be two visits within 30 days, with continuing periodic treatment being at least two per year.

The new rules would also provide for each spouse to take a full 12 week FMLA leave to care for an adopted or foster child in serious health, regardless of whether the spouses work for the same employer.

The new regulations would also address amount of leave during a holiday period, overtime during leave, reduced schedules, substituted paid leave, health insurance upon return to work, bonuses, notification of eligibility, employee notices, and medical certifications.

The full proposal, including background information, is available at www.dol.gov. Instructions are also available for commenting on the new proposals if desired.

Youth

As summer approaches, it may be traditional in your location or industry to hire minors while they are on summer vacation from school. Employers need to be aware there are very strict laws on age, hours and type employment minors can engage in and penalties for noncompliance can be very harsh.

There are different rules for 14-15, 16-17 and 17 and older youth. Therefore, you must be aware of the differences based on age and not allow all summer workers to perform the same task. For example, minors under 17 cannot drive a vehicle for your business, 16-17 year-olds cannot do roofing, 14-15 year-olds have restrictions on cooking related tasks, with the list going on and on.

If you plan on hiring summer youth this year, go to www.dol.gov/elaws/esa/flsa/cl. Knowing the rules can reduce injuries to workers and fines for employers.

The Department of Labor has also announced as part of their 2008 agenda, the release of final regulations revising the list of jobs allowed for those 14-15 years of age and further review of hazardous jobs for youth. The Department is further pushing for increased fines for child labor violations of up to \$50,000 for some violations, and up to \$100,000 per violation for repeat offenders.

Additional information on the proposed regulations is also available at www.dol.gov.

Budget

The budget proposal submitted for fiscal 2009 contains many items impacting payroll, with most previously submitted in prior budgets. These are only proposals and whether they will become

law, especially in an election year, is clearly up to Congress. Whether enacted or not, many of these topics will make their way into the election year debates and could reappear in some form for years to come.

Tax Cuts

The 2001 tax cuts for individuals set to expire at the end of 2010 are once again proposed to become permanent in this budget. These items include the 10% tax rate bracket, increased standard deduction and expanded 15% tax rate bracket to eliminate the marriage penalty for couples, the reduction of the top tax rates, increased child tax credits, and the expanded income exclusions for education assistance provided by employers.

Health Insurance Deduction

A proposed standard deduction of \$15,000 for families, or \$7,500 for singles, would be available for those who purchase health insurance that meets government guidelines. The deduction would be available for coverage purchased directly or through employers. It would replace the current income exclusion for employer-provided health insurance, self-employed premium deductions, and the medical itemized deductions in current law.

Employer Retirement Savings Accounts

All pre-tax defined benefit plans (current 401(k), 403(b), and 457 plans) would be consolidated with simplified rules into new Employer Retirement Savings Accounts.

Retirement Savings Accounts

The budget proposes to consolidate traditional, Roth and non-deductible IRAs into a single Retirement Savings Account dedicated only to retirement savings, with any other withdrawals subject to tax and penalty. Existing IRAs could be converted to the new plans and would be replaced by the new plans for future contributions.

Information Reporting

As proposed in prior years, reporting for all payments to an independent contractor of \$600 or more, would require certification of the recipient's taxpayer i.d. number. If a verified tax i.d. number is not available, the business would be required to withhold taxes from the payments and remit the taxes to the IRS. Recipients could also request withholding from gross payments to them. Payments to corporations would also be reportable, and government entities would be required to report payments under the proposed budget.

Other Proposals

Other proposals would open up the National New Hire Directory to the IRS for tax administration and data matching purposes, extend the 0.2% Federal Unemployment Tax Act surcharge, extend the penalty-free retirement plan withdrawals for active-duty armed services members, reform social security through voluntary personal accounts funded by a portion of social security taxes, and increase child support collection efforts, as well as hire more wage and hour investigators.

Tax Gap

There is an old saying that the difference between a good tax and a bad tax depends on whether it applies to you or someone else.

We are now hearing a lot about the "tax gap" from the IRS, Congress and the media, and unfortunately it impacts all of us. Defined as the difference between what taxpayers should have paid and what they actually paid, the tax gap is approaching \$400 billion per year.

Since we have a voluntary, pay as you go tax system, employers and payroll related activities are one of the primary tools for administering the system. And not unlike a chain, it is only as good as the weakest link.

One of the main areas of concern related to the tax gap is considered to be worker classification and reporting of payments to and by independent contractors. The classification and reporting of payment aspects are employer responsibilities under our tax system.

The National Taxpayer Advocate has called for changes in this area in the last few annual reports to Congress. The report notes that payments to independent contractors not reported on 1099s, and those not reported as income by the independent contractor, is the largest single component of the tax gap.

The Taxpayer Advocates' office recommends that noncompliant independent contractors be targeted through backup withholding on 1099s, where the recipient has been identified by the IRS as a person not complying with tax laws.

he report further recommends that payments to recipients now covered by 1099 reporting have the social security number validated before making any payments. If unable to validate the number, then backup withholding would be required beginning with the first payment. This obviously would require expansion of the validation process by employers.

This report from the Taxpayer Advocate and the proposals in the current budget package (page 1) indicate the seriousness of the problem, and that some corrective action will probably be made in this area soon.

So what can an employer do now to make sure they are not one of the weak links in the tax compliance chain? Make sure you are aware of the employee versus independent contractor rules and properly treat a person as an employee when required.

Usually if you can control what and how a job is done, an employee relationship exists. If you only control the results of the job, a contractor relationship exist. The determination of these relationships falls into three categories; behavioral controls, financial controls and the perception of the relationship.

If you control the instructions on how to do something, the methods to do something, and the training to do something (how, when where), there is probably an employee relationship.

The party that has the financial risk, i.e., who pays for the tools, materials and other expenses related to the job, is key. If it is not the person doing the job, then there is probably an employee

relationship. Also, if the person is paid on a regular basis and not upon completion of the job, the person is probably an employee.

If the written contract provides for any benefits, the relationship exceeds the project life and the importance of the job to the overall business is significant, an employee relationship probably exist.

Another area where employers can aid in cutting the tax gap is to make sure all payments to independent contractors for \$600 or more are properly reported on Form 1099s, under existing information reporting requirements. This requires setting up procedures to secure a Form W-9 prior to any payments being made to a contractor.

This will ensure you are making a good faith effort to comply, will reduce the potential for penalties for non-filing, and will also allow you to make sure you receive an income tax deduction for those payments should your income tax return be audited.

Also, an independent contractor is far more likely to report income if they receive a Form 1099 than when required information reporting is not made. Thus, you are shifting the compliance burden to someone else.

Since the tax gap is a known problem, current law requires a determination of the employee/independent contractor status and information reporting is required. So make sure your operation is in compliance to avoid unnecessary problems for your company as the laws in this area are tightened in the future.

Additional information on the tax gap, taxpayer advocate report, employee/independent contractor rules, and information reporting are available at www.irs.gov.